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SUBJECT: RISING CONSTRUCTION COSTS PROMPT GOE ACTION

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Summary  
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¶1. (U) In late March the Ministry of Trade and Industry (MOTI) announced a six-month ban on cement exports, beginning April 1. The ban is the latest in a series of steps by MOTI to control rising construction prices. Industry analysts predict the ban will not bring cement prices down, as demand will remain high as Egypt's construction boom continues. Mona Yassin, head of the Egyptian Competition Authority (ECA), said that MOTI's collusion case against cement producers is not likely to bring down prices either, as penalties under the Competition Law are not high enough to act as a deterrent. Jaime Muguiro of Cemex (protect) told us that the collusion case was mostly political, and wouldn't affect construction prices at all, as cement accounts for only 8% of average construction costs, while steel constitutes 30%. The GOE has taken some measures to control steel rebar prices, including referring steel traders to court for violating marketing regulations. ECA will also issue the results of an investigation of anti-competitive behavior among steelmakers later this month.

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Ban on Cement Exports  
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¶2. (U) On March 27 MOTI announced a six-month ban on cement exports beginning April 1. This is the latest step by MOTI to control local cement prices, which reached LE450 (\$81)/ton in March, ex-factory (from producer to trader), up 11% from LE400 (\$73) in February. In August 2006 MOTI imposed a voluntary domestic price cap of LE290 (\$52)/ton ex-factory, reasoning that producers enjoyed subsidized energy and should therefore keep local prices low. Producers turned to exporting, however, taking advantage of higher, market-driven international prices (regional prices are currently averaging \$90/ton). With domestic supply limited due to exporting, and demand strong because of a construction boom in Egypt, producers ignored the voluntary price cap, prompting MOTI to impose export tariffs of LE60 (\$11)/ton in February 2007. In August 2007, MOTI increased the tariff to LE85 (\$15)/ton, announced plans to remove energy subsidies by 2010, and issued 9 new cement production licenses. Despite these measures, local prices continued to rise, prompting MOTI to refer cement producers for prosecution in October 2007, after ECA found evidence of collusion among producers to keep prices high.

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Prices Expected to Remain High

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13. (SBU) Analysts predict the export ban, coupled with new production facilities coming on line this summer, will increase domestic supply by about 3 million tons. But strong domestic demand fueled by the continuing construction boom will keep prices steady, or could even push them higher, though not as rapidly as in the last few months. Mona Yassin, head of ECA, told us that even the Prosecutor General's decision to press charges against the cement companies named in the collusion case is unlikely to have an effect on prices. The Competition Law allows for a maximum penalty of LE 10 million (\$1.8 million) if companies are found in violation of the law. Some of the companies make more than this in profit in one month, according to Yassin, who told us she would like to see the law amended to make fines dependent on a company's profits. A verdict in the collusion case is expected by May, Yassin said.

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Competition Case Political, Not Economic  
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14. (SBU) Jaime Muguiro, President of Assiut Cement, a subsidiary of Mexico's Cemex (protect), said he understood the GOE's efforts to keep construction prices low, but felt the collusion case was more political than economic. MOTI wants to make an example of the cement industry, which is now dominated by multinational corporations such as Cemex and Italy's Italocimento. The GOE wants the public to believe it is protecting consumers from big business interests. Construction costs are especially important in Egypt, as families from all classes construct houses themselves, buying building materials as their cash flow permits. A steep rise in construction material prices from one month to the next has a pronounced effect on consumers' ability to continue or complete construction projects.

15. (SBU) Muguiro claimed the Prosecutor General's office found no evidence of collusion among cement companies, but MOTI pressed for prosecution of the case. The verdict is a foregone conclusion, Muguiro believes, and will send a bad signal to potential investors.

The irony is that cement constitutes only 8% of average construction costs. The real drivers of inflation in the construction sector, according to Muguiro, are rising land and steel prices. Land sales constitute direct revenue for the GOE, so land prices are likely to continue rising as long as demand remains high.

Steel, on the other hand, is a sacred cow for the GOE, as prominent NDP member Ahmed Ezz owns Egypt's largest steelmaker, Ezz Steel. The GOE will not take aggressive measures to control steel prices, Muguiro believes, even though steel constitutes around 30% of average construction costs.

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Measures to Control Steel Prices  
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16. (U) Muguiro's prediction of leniency for the steel sector notwithstanding, the GOE has taken some measures to control prices of rebar, the steel most often used in construction. In early March MOTI inspectors discovered 11 steel traders (middlemen who buy steel from producers and sell to construction firms and retailers) withholding supplies of rebar from the market in anticipation of price increases. MOTI referred the traders to the Prosecutor General for violation of MOTI marketing regulations for construction material. Steel traders told the press the case would not dampen prices, as many steelmakers, among them Ezz Steel, have reduced production by up to 25% to keep prices high. MOTI also issued a decree in late March prohibiting steelmakers from reducing production levels or suspending sales without MOTI's approval. The decree authorized 1-5 year prison terms and fines ranging from LE300-1,000 (\$54-181) for executives of companies found in violation of the decree. Despite these measures, rebar prices jumped 11% to LE6,000 (\$1,090)/ton in March, up 11% from LE5,400 (\$981)/ton in February.

17. (SBU) ECA's Yassin told us that the results of an investigation into anti-competitive behavior of steelmakers, including Ezz Steel, will be released this month. She noted that the steel investigation took longer than the investigation of the cement sector because MOTI wanted "strong evidence" against any steelmakers (read: Ezz Steel) found in violation of the Competition Law.

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Comment  
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18. (SBU) An ECA finding of collusion among steelmakers is not likely to have much impact on steel prices, just as the collusion case against cement producers did not bring down cement prices. But a case against steelmakers, unlike cement producers, would resonate among Egyptians, as it would demonstrate willingness to challenge NDP insiders such as Ezz. The message both the cement and steel cases send to investors, however, could be more mixed, potentially causing some to pause as they consider expanding or entering Egypt's steel and cement sectors.  
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